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Bombay High Court holds that buyback of shares under a Scheme of Arrangement in accordance with section 391 read with section 100 – 103 of the Companies Act, 1956 is not a colourable device to evade tax

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Synopsis

- The High Court has held that company can, at its option, buy back its shares by following the procedure prescribed under Section 77A (corresponding to section 68 of Companies Act 2013 [2013 Act]) or by following the procedure prescribed under section 391 read with sections 100-104 of the Companies Act, 1956 [1956 Act] (now section 230 read with section 66 of the 2013 Act) until section 230(10) of the 2013 Act comes into force.
- The High Court has further held that merely the fact that the buyback under section 391 read with section 100-104 of the 1956 Act may not attract income tax will not amount to it being a device to evade tax.
- The issue relating to income tax that may arise out of the Scheme has however been left open to be dealt with and decided by the income tax authorities in accordance with law.

Facts

- The taxpayer company, Capgemini India Private Limited, had filed Petition with the High Court for seeking sanction of the Scheme of Arrangement (“Scheme”) entered with its equity shareholders for buyback of its shares which represented 30% of the issued, subscribed and paid up share capital.
- The Scheme was drawn in accordance with the provisions of section 391 read with sections 100 to 103 of the 1956 Act.
- The Petition was admitted by the High Court.
- The Regional Director raised objections and opposed the sanction of the Scheme on the contention that the buyback of shares must be effected only under Section 77A of the 1956 Act / Section 68 of the 2013 Act and that if the Scheme is sanctioned under section 391 read with section 100 to 103 of the 1956 Act, it would result in evasion of income tax and outflow of foreign exchange to the tune of INR.2.48 billion. According to the Regional Director, the taxpayer is not following the procedure prescribed under

section 77A of the 1956 Act / section 68 of the 2013 Act to evade tax liability on the distributed income as provided in section 115QA¹ of the Act.

Issue before the High Court

Whether the Petition filed in relation to Scheme with the equity shareholders for buyback of shares of the taxpayer company should be sanctioned keeping in mind the contentions raised by the Regional Director?

Ruling of the High Court

- The High Court rejected the objection of the taxpayer that the Regional Director has no *locus* in respect of tax matters by relying on the decision of the Bombay High Court in the case of Casby CFS Pvt. Ltd.² wherein it has been held that the Regional Director has the requisite *locus standi* to raise all objections in respect of a scheme including objections pertaining to taxation laws even if the income tax authorities do not raise any objection.
- The High Court observed that in its decision in the case of SEBI v. Sterlite Industries (India) Limited³ it was held that a company may either follow the procedure under section 391 read with sections 100 to 104 of the 1956 Act or the procedure under section 77A (now section 68) for buying back its shares.
- Section 230(10) of the 2013 Act allows sanction of buyback scheme only if it is in accordance section 68 of the said Act. The said section 230 has however not come into force. Accordingly, the decision of Sterlite Industries (India) Limited (*supra*) prevails and will be applicable to the present case. The Petitioner is therefore entitled to buy-back its own shares by means of scheme under section 391 read with section 100 to 103 of the 1956 Act.
- If the law permits a company to buy back its shares in more than one way, the company cannot be compelled to follow only a particular method that results in payment of income tax. It is well-settled that a taxpayer can always manage his affairs in the

¹ Special provisions relating to tax on distributed income of domestic company for buy-back of shares

² CSP Nos. 137 and 138 of 2014 dated 19 March 2015

³ (2003) 45 SCL 475

manner so as to avoid payment of tax. In the present case, since it is legally permissible for the company to buy back its shares by following the procedure under section 391 read with section 100 to 104 of the 1956 Act, the fact that the same may not attract income tax will not amount to it being a colorable device to evade income tax.

- Circular No.49 dated 4 May 2010 issued by the Reserve Bank of India (“RBI”) provides that shares of an unlisted Indian company can be transferred by a non-resident to a resident under the general permission of the RBI if the transfer price does not exceed the fair market value as determined by a Chartered Accountant or SEB registered Merchant Banker as per Discounted Cash Flow method. In the present case, the transfer price has been arrived at in accordance with the aforesaid circular of RBI. The Regional Director has not disputed the fair market value of the shares determined by the taxpayer and hence the buyback of shares is in accordance with the RBI Guidelines and there is no question of there being any draining away of foreign exchange as claimed by the Regional Director.
- In view of the above, the High Court sanctioned the scheme but with a clarification that the issues relating to income tax that may arise out of the Scheme are left open to be dealt with and decided by the Income-tax Authorities in accordance with law.

Comments

The Bombay High Court has upheld its earlier decision that it is not necessary that buyback should be undertaken only by following the procedure laid down under section 77A of the 1956 Act 1956 (now section 68 of the 2013 Act). The buyback is also permissible to be undertaken by following the procedures laid down under section 391 read with sections 100 to 104 of the 1956 Act (now section 230 read with section 66 of the 2013 Act).

Further, the issue whether buyback under section 391 of the 1956 Act will result in any tax liability under section 115QA of the Income Tax Act, 1961 has been left open to be dealt with by income tax authorities in accordance with law.

Source: Bombay High Court's decision in the case Caggemini India Private Limited (Company Scheme Petition No. 434 of 2014 connected with Company Summons for Direction No. 396 of 2014)

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